

**THE FUTURE APPROACH TO SETTING GLOBAL
FINANCIAL REPORTING STANDARDS –
IN FAVOUR OF TRUST AND INTEGRITY**

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Abstract. *The experience in developing principles and standards in the field of accounting and financial reporting, bankruptcies and other events around the world indicate that a new approach is needed to restore the trust and consolidate the integrity of the profession.*

The consequences of the financial crisis question the benefits of further action in support of the convergence. A consensus and agreement have been reached that the economic reality in the world has changed to an extent where the strategy and policy of convergence could hardly be as appropriate and efficient as they were for the past period.

The concept that the convergence cannot be a key driving force any longer has been gaining more and more supporters. The efforts must be focused on the joint development of a new set of global financial reporting standards in duly identified key priority areas. The people concerned would best be served by high-quality financial information, and such information could be provided by means of a single set of global financial reporting standards, based on principles, and set by a single independent world institution.

Key Words: *Financial reporting, convergence, strategy, policy, global financial reporting standards, a single independent global standard setter, jurisdiction.*

1. The experience, gained in the complex process of developing, defining and applying International accounting standards (IAS)/International financial reporting standards (IFRS), and the not less complex development and setting of a conceptual framework in accounting and financial reporting, as well as the dramatic events which have occurred during the past decade, indicate that investors, creditors, hired employees, and other people concerned, institutions and society, **need a new approach which will restore the trust in accounting as a reliably functioning system and practical activity, and con-**

solidate the integrity in the trade¹. In the context of the present financial crisis it is more than clear that there is a need for the changing of the paradigm.

The bankruptcies of companies, ostensibly powerful until their downfall, new global phenomena and processes, little investigated so far, and other factors and driving forces, have led to social conflicts and tension in different parts of the world, caused insecurity and commotion, and made the investors hesitant. All this has caused the concern of the financial elite, alarmed the credit institutions, the organizations of professional accountants, auditors, etc. Many and significant issues have arisen, and their analyses have generated doubts of mistakes, made deliberately or inadvertently, of relinquishing of "outdated" principles of accounting², long and consistently pursued in continental Europe and elsewhere. Suspicions have arisen, of unscrupulousness and "adaptation" by means of compromising rules and norms, allowing "adulteration" of accounting results to serve someone's interests.

2. It is beyond doubt that some of the issues, which, because of their nature and importance are currently being discussed must within a short term period continue to be subject to a wide international public debate, in which there must participate independent scientists in the field of accounting, analysis and audit, jurisdiction and law, experts, practicing and professional accountants, auditors, independent evaluators and other specialists from the financial and non-financial sectors, and consumers of course, are as follows:

- To what extent the economic information, contained in the financial reports of general purpose, is and could be reliable, pertinent (and useful) for investors, governmental and non-governmental institutions and agencies, the financial analysts and other people concerned with the economic and political environment which is dynamically changing and incessantly becoming complicated these days;

- Why were bankruptcies and scandals not prevented, as was the "Enron"³ case of December, 2001, as well as the bankruptcies and scandals that followed suit? Why did this happen and couldn't it have been avoided;

- Is the information, created in and through accounting, a sufficiently good basis for analysis, assessment and forecasts, and if this is the case, why were events, which are known to inflict long-lasting damage to the trust and are detrimental to society as a whole, as well as other people more directly concerned, not "avoided";

- Does a problem exist or not in accounting methodology, which has so far remained unnoticed because of the fact that the economic activity and accounting and reporting practices, in which this activity finds subjective reflection, were not so complicated as to make it stand out and become noticeable.

¹ It must be interpreted as wholeness, totality of the profession.

² Accounting Principles by Philip E. Fess, PhD, CPA, Professor of Accountancy, University of Illinois, Champaign-Urbana и Carl S. Warren, PhD, CPA, CMA, Professor of Accounting, University of Georgia, Athens, Fifteenth Edition, Published by SOUTH-WESTERN PUBLISHING CO, 1987, pages 557 and 558. SOUTH-WESTERN PUBLISHING CO, 1987.

³ After the bankruptcy of Enron company, the controversy and criticism of the Generally Accepted Accounting Principles of the USA assumed a bitter character. Fritz Bolkestein, Commissioner of the European Union at the time, strongly criticized the book Generally Accepted Accounting Principles of the USA and called upon the USA to switch to the International Financial Accounting Standards (IFRS).

▪ And hence, is this methodology sufficiently reliable nowadays as well, when states, markets, institutions, economic agents, other legal entities and physical persons are facing the prospect of a growing complexity of the economic activities and environment (in which they all function) and are also facing complex interaction and relations between them.

▪ Or else some of the reasons for the grave problems must be looked for elsewhere – not among the combination of methodological means, realizing the accounting and financial activities, as a result of which, information is generated. Isn't it more probable that some of the problems are due to the possibilities of a choice from among several allowed alternatives, and application of various evaluation models and rules, thorough which, often "devoid" of real economic explanation and subjected to ad hoc considerations, there is predetermined and recognized a deliberately increased, "inflated" profit or a reduced, lowered loss from the transactions for a past period (or vice versa).

Not little possibilities are being presented these days, "freedom" of choice and application of accounting policies, as well as for changes in these policies when it is considered that they are necessary for the preservation of the reliability of information, designed to reach consumers. It is possible that two or several enterprises making financial reports are functioning in one branch or even in a branch sector of the economy, with the probability not being ruled out that they are similar in terms of scale and subject of activity, while at the same time they may apply different individual policies. The question arises of whether the possibility of a "free choice" of policy and for a change in it (albeit it is considered to be an exception rather than a rule) is in contradiction with well-known normative requirements (proclaimed by the Anglo-Saxon school) about the "quality" (qualitative characteristics) of information in the financial reports (which are considered to determine the extent of its usefulness for consumers). For example, a prerequisite which is a necessary condition for the achievement of "comparability" is the adherence to consistency (and constancy) in time in the evaluation of the financial effect of similar transactions and events. When, however, in practice, the "consistency" turns out to be in conflict with the relevance (pertinence) and reliability, in other words, when the consistency harms the authenticity (and could lead the concerned parties to deception) how do we exactly determine the balance or the compromise (prescribed in the General Provisions / Framework for the Preparation and Presentation of Financial Statements⁴ concerning preparation and presentation of financial reports), so that the purpose of the financial report is accomplished. Examples of such contradictions could be given. What is stipulated in the General Provisions is that "the relative importance of the characteristics in different cases is a matter of professional judgment". Nevertheless, there is no answer to the question of what happens if the judgment is not impartial or unbiased, albeit it may look professionally made. Who bears the brunt when there is not any real possibility (alternative) to reach such a balance? If the attention of the management is focused on "problems" of a different nature, not so much on the quality of the information, presented in the financial report, where is the responsibility? Without aiming at it, we inadvertently resort to moral categories and aspects of the issue – may be because in some cases the boundary between the moral-ethical and professional performance of the accountant is rather delicate, un-

⁴ The Bulgarian translation of the Framework for the Preparation and Presentation of Financial Statements is published by IDES in Bulgaria, Sofia, 2005. International Financial Reporting Standards (IFRS), IDES, 2005, Part I.

clear and blurred. The proving of deliberation or exerted pressure (because of some instance of dependence, coercion or other reasons) is always rather problematic and involves certain risks. As a matter of fact this is the same in life, not only within the boundaries of the profession.

Another part of the problems is most probably due to the "asymmetry", permissible (and unavoidable according to specialists) in the process of evaluating some subjects of accounting (for example inventories, financial instruments and others) for the purpose of their presentation in the financial reports.

Each of the issues, hitherto raised, apart from being complex and potentially controversial (and therefore could be a part of the scope and subject of a public debate), needs a substantiated answer which could have a key or important significance for the development of an appropriate strategy and policy for the future.

The cardinal (fundamental) issue however is how, in what way and by what means and ways the relevance (pertinence) of the financial reporting in its necessary and desired form in the future could be retained and "preserved"?

3. The economic and financial slumps and collapses which have shaken the world have questioned the benefits of a further support of the efforts and activities, necessary for the purposes of convergence. In this wide-scope process there participate international organizations, work teams and specialists from different countries. United by the progressive idea of a highly regulated uniformity and unification in accounting and financial reporting, they work towards a further convergence. The strategy⁵ and policy⁶ of convergence by means of a gradual reduction and elimination of the differences for the needs of financial reporting could however hardly be so pertinent and efficient, as they used to be for the past period. The crisis has turned into a factor under whose influence it was realized that the financial, economic (and political) reality in the world has changed. And what is more, an agreement and consensus have been reached that it is necessary to substantially rethink and reconsider the role of accounting in the context of a crisis and undertake respective measures to modify it. This statement is based on judgments and assessments of academicians, professional accountants and representatives of international organizations in the field of accounting concerning the consequences of the crisis.

It is clear that there is a need for a new vision for the future of financial reporting and for a change of the existing model – it is necessary to develop, adopt and introduce sole global and principle-based accounting standards. The convergence must not and cannot be a key force anymore, and therefore the attention and efforts of the International Accounting Standards Board (IASB) must be focused on the joint development of new standards in respective areas, defined as being of key and prior importance⁷.

⁵ General tendency, preliminarily drawn, in the management of war, battle, activity which must (is expected) to lead to a victorious, successful end or until the accomplishment of a definite purpose.

⁶ A definite, chosen way of action of a physical entity or an institutional body for accomplishment of its goals.

⁷ Statement of the Federation of European Accountants (FEE, FEA) presents the vision of the need for a change of approach in the future. The Federation expresses its statements on issues, connected with the financial crisis, sustainability, audit and security. Cf. Statement of the Federation of European Accountants (FEE, FEA) Conference Financial Reporting in a Changing World, 2009.

4. This is also the belief of the respected representatives and numerous members of competent international organizations, such as the Federation of European Accountants (FEE, FEA). The Federation (FEE, FEA) represents 43 professional institutions of accountants and auditors from 32 European countries among which are also all of the European Union member-states. The Federation (FEE, FEA) represents the European accounting profession and the guiding principle in the activity of the Federation is the recognition of public interest. More than 500,000 professional accountants are members of this organization. They work in various spheres of social life, in big and small enterprises, in the system of the administrative and economic management and education, and they contribute to a more efficient, transparent and sustainable European economy.

5. The strategy of the International Accounting Standards Board (IASB) for convergence is yielding good results for the period from its establishment, through 2000 until today and it is appropriate and pertinent to apply throughout this period. In many states and countries now there have either been adopted the International Accounting Standards (IAS) / the International Financial Reporting Standards (IFRS) in their full version, or the differences between IAS / IFRS and the national standards functioning in separate countries have to a great extent been reduced. During the past period of almost a decade the convergence project played a big role for the elimination or reduction of the differences in response to the basic requirement for a convergence between the International Accounting Standards (IAS) / International Financial Reporting Standards, (IFRS), applied in the European countries and elsewhere, and the General Accounting Principles of the United States (GAAP US). All this was also in support of the idea, connected with the adoption of the International Financial Reporting Standards (IFRS) in the United States of America.

The competent international organizations such as the Federation of European Accountants (FEE, FEA) are however of the opinion that a period of a reduced rate of return from the convergence has set in, a period of less and less benefit from the convergence as a result of an increase of the complexity of financial reports, without noticing hardly any benefits for the investors, which would have normally been reaped when the purpose was to eliminate the diminishing differences between the International Financial Reporting Standards (IFRS) and the General Accounting Principles (GAAP US).

The conclusion is reached that it is necessary for the International Accounting Standards Board (IASB) to change its strategy and in a medium-term plan concentrate its efforts on the main improvements and simplifications of the International Financial Reporting Standards (IFRS). For this purpose it is necessary for the Board to work jointly with all world standardization institutes, so that all concerned participants could be completely involved in the process, and, moreover, they must be assured that there will be no compromise whatsoever concerning quality. This means that the number of active projects must be considerably reduced and that the attention must be focused on those which really prepare a fair environment (of equal placing and independence) for development of the future standards.

The author expressed her deep conviction that the states, countries, markets, economic agents and other concerned consumers would best be served by high-quality financial information and that such information could best be provided by means of global financial reporting standards which must be developed and set by one sole independent world institution of accounting and financial reporting. The issue is for which enterprises the global financial reporting standards should be designed – whether it should be for all companies, or only for the ones that have access to world and national capital markets.

Today there is a wide consensus that the states (and countries) from G20 must urge the International Accounting Standards Board (IASB) to make as full use as possible of the existing experience for setting high-quality financial reporting standards in the whole world, including the experience of The Financial Accounting Standards Board of the USA (FASB US) and the European Financial Reporting Advisory Group (EFRAG) in order for them to work together for new principle-based global solutions in the fields that are really of importance to investors⁸.

6. During the last years the convergence in accounting and financial reporting is a process and factor for the realization of the programmes of the International Accounting Standards Board (IASB) and the priority issues, connected with them.

The convergence between IFRS and GAAP US has had an impact on the programme activity of the International Accounting Standards Board (IASB) in two ways. It has led to a number of long-term joint projects with the Financial Accounting Standards Board (FASB US) on important issues such as for example the recognition of revenues, leases and others and is the main driving force of a number of short-term projects. With respect to the long-term projects a consensus is expressed that they are important although not necessarily urgent. It cannot be contested that the joint activities with the Financial Accounting Standards Board of the USA (FASB US) are an effective way of developing high-quality standards. With respect to the shorter-term projects, the result of them boils down to gradual revisions and comparatively small changes in the International Accounting Standards (IAS) / International Financial Reporting Standards (IFRS), which are not necessarily important improvements of the standards and which have contributed and are contributing rather to a lack of stability in the normative base. The issue arises of whether the benefits of such improvements are not less than the expenditures incurred for them and the "problems" which they cause for practice. Moreover, the standards which were revised (rehashed) or are currently being revised as a part of the short-term convergence programme, are not often considered an important priority from the viewpoint of IFRS. As recent examples in this respect there can be indicated the changes in the rules of the recognition and capitalization of borrowing costs and income taxes. It is considered that a point of development has been reached where the benefit of the further convergence with GAAP US decreases especially because of the fact that more and more countries tend to directly adopt IFRS in their full version, including countries with powerful economies such as Japan and India.

According to the Federation (FEE, FEA), there must be achieved an accurate balance between the speed and nature of the changes particularly in those places where the existing IAS / IFRS are not considered to be causing problems which must necessarily be solved or that IAS / IFRS are in some way a prerequisite for the emergence of these problems. The Federation of European Accountants (FEE, FEA) calls upon the Foundation of the Committee of International Accounting Standards (IASCF), along with the Board (IASB), to lay the beginning of an annual process of a public consultation concerning the operation plan of the Board, so that a concrete procedure is started, which

⁸ Cf. Statement of the Federation of European Accountants (FEE, FEA) Conference Financial Reporting in a Changing World, 2009.

must be sufficiently far-sighted and through which issues must be added and also removed (eliminated) from the operation programme of the Board. The completion of such a public consultation would also contribute to the familiarization with the priorities of the Board and to the solution of the problem, connected with the overloading of the current agenda.

The Federation of European Accountants (FEE, FEA) is of the opinion that now the appropriate moment has come for the Board (IASB) to support the idea of initiating a public consultation on its operation plan, bearing in mind the clear need for reconsideration and revision of the priorities, taking into account the consequences of the financial crisis and focus on the main improvements and simplifications. The number of the active projects must be considerably reduced.

7. The convergence concept and the role which the process of convergence plays for defining the priorities of the Board (IASB) must be reconsidered. **The Federation (FEE, FEA) is of the opinion that the existing model of convergence is no longer sustainable as a result of the increasingly diminishing benefits – therefore there is a need for a new approach which must be based on the joint work towards the creation of decisions for high-quality and principle-based financial reporting in duly indicated areas which are of key priority.**⁹ The development of the new standards of financial reporting must "outgrow" the national way of thinking, and go beyond the thinking in the framework of the existing national accounting standards. The joint development and concomitant implementation of new global principle-based standards on the part of all participants is (probably) the best way to the development of high-quality standards and the establishment of a fair basis, without one jurisdiction being placed before the other. Then the Board (IASB) would really function as an international institution.

The development of new standards and the improvement of the existing ones must be managed by an operation plan outlining clear priorities and justifying the need for changes. Although there must be a continuous improvement of the standards, the realized improvements must be assessed with respect to the expenditures and benefits from them. In other words, the improvements must be made only in areas which really are of importance. The new standards on important issues such as financial instruments, pensions and others must be developed jointly with the Board (IASB) and with the best standardization resources, functioning at a national or regional level, with the active participation of information consumers and accountants of world renown. This would guarantee that the attained results will be universally accepted in the real sense of the word and in its turn would facilitate the adoption of IFRS on the part of all leading countries in the world. In order for the desired terms of justice to be established (created), all countries must be called upon to adopt IFRS in their full version. This means that the national standardization institutions must give their support for the preparation of a draft decision concerning IFRS in order to guarantee that IFRS correspond to the needs of the participants in their countries and contribute to the process, directed to the way in which the best solutions for accounting and financial reporting should be developed. In Europe, EFRAG, in which main European standardization institutions participate, plays an important role. EFRAG

⁹ Cf. Statement of the Federation of European Accountants (FEE, FEA) Conference Financial Reporting in a Changing World, 2009.

can and is expected to have increased resources which could dedicate themselves to the work in order for it to turn into a main factor in the discussion of issues which are of importance to the European participants.

8. In April 2009 G20 called upon the world standardization institutions in the field of accounting standards to continue their work towards a single version of high-quality world financial reporting standards. The urge was hailed and strongly supported also by the Federation of European Accountants (FEE, FEA). The recent political pressure, exerted both on the International Accounting Standards Board (IASB), and on the Financial Accounting Standards Board of the USA (FASB US), to create a fair environment between IFRS and GAAP indicates the risk of driving the global financial reporting towards the least common denominator at the expense of the users of the information in the financial reports. This tendency must be avoided. G20 thinks it necessary for the Federation (FEE, FEA) to stimulate the separate countries and states to move towards the adoption of the full version of IFRS. The American regulatory plan of June, 2009 gives a green light for this to happen¹⁰.

It is necessary that the states from G20 should urge the Board (IASB) to use all its knowledge and experience to achieve high-quality accounting standards, including the knowledge and experience, gained within the framework of the Financial Accounting Standards Board of the USA (FASB) and the European Financial Reporting Advisory Group (EFRAG), in order to work jointly for new global solutions in those areas which are really of importance to investors.

9. Vision for the future

How do we sustain the relevance (pertinence) of the financial reporting? The present crisis indicates that the financial reporting is still quite pertinent and that it must be guaranteed that it will continue to be such in the future though a greater concern for the needs of people and institutions, ensuring the information, for the needs of investors and creditors; through guaranteeing that it reflects the basic economic reality and that the information is meaningful with respect to communication. For this purpose it is necessary to have principle-based standards and reduce the complexity of the financial reports. It is no less important that there should be communication with shareholders, investors and consumers on the basis of audited financial reports. This in its turn means that the management of the enterprise and the financial management team must be responsible for the quality of the submitted information. On the other hand, the investors and other interested consumers are expected to give a respective confirmation about whether the provided information is reliable or not. It is necessary to recognize also the shortcomings and weak points of the financial reporting, take risks into account, use professionally prepared information and other non-financial data, and ensure sustainability and transparency. Not of less impor-

¹⁰ The European Financial Reporting Advisory group (EFRAG) and the setter of financial accounting standards in France – Autorité des Normes Comptables (ANC), published research, connected with the definition of an asset. The research was carried out because of the fact that the International Accounting Standards Board (IASB) and the Financing Accounting Standards Board (FASB) offer a new definition of asset. Both of the boards made the suggestion in the context of convergence and within the framework of the project of preparing a common conceptual financial reporting framework.

tance is the issue of whether the disclosures are well-balanced. Moreover, is there a need for framework? How should the relevant and more meaningful disclosures be found?

The fair environment is not impossible to attain. A manifestation of the risk of moving towards the least common denominator must not be allowed. An assessment of the political risk is necessary – where should we have it and where not? And where does responsibility remain?

In all cases, the independence of the institutions, setting the standards, must be guaranteed.

It is necessary to guarantee that the financial reporting will continue to be pertinent through focusing the unified efforts of the international standardization institutions and all concerned on new global solutions in key areas and reconsideration of the goals of convergence.

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STANDARDI FINANSIJSKOG IZVEŠTAVANJA – U PRILOG POVERENJU I INTEGRITETU

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Iskustva u razvoju principa i standarda u oblasti računovodstva i finansijskog izveštavanja, bankropstva i drugi događaji širom sveta ukazuju na to da je potreban nov pristup koji bi povratio poverenje i učvrstio integritet profesije.

Posledice finansijske krize dovode u pitanje koristi daljih akcija koje podržavaju konvergenciju. Konsenzus i dogovor su postignuti da se ekonomska stvarnost u svetu promenila do te mere da strategija i politika konvergencije nisu više odgovarajuće i efikasne kao što su bile u proteklom periodu.

Koncept da konvergencija ne može više biti ključni pokretač dobija sve više pristalica. Napore treba usmeriti ka zajedničkom razvoju novog seta globalnih standarda finansijskog izveštavanja u pravovremeno identifikovanim prioritetnim oblastima. Zainteresovanim stranama najviše bi pomogle visoko-kvalitetne finansijske informacije, a takve informacije bi pružao jedinstven set globalnih standarda finansijskog izveštavanja, na osnovu principa, i donešen od strane jedinstvene nezavisne svetske institucije.

Ključne reči: finansijski izveštaj, konvergencija, strategija, politika, globalni standardi finansijskog izveštavanja, jedinstveno nezavisno globalno telo koje određuje standarde, nadležnost.